

REPORT ON EXAMINATION OF
BLUECROSS BLUESHIELD OF TENNESSEE, INC.
CHATTANOOGA, TENNESSEE

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Dept. of Commerce & Insurance
Company Examinations

AS OF

DECEMBER 31, 2010

THE DEPARTMENT OF COMMERCE AND INSURANCE

STATE OF TENNESSEE

NASHVILLE, TENNESSEE

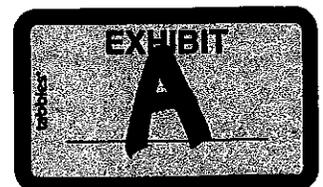


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Chattanooga, Tennessee
June 20, 2012

Honorable Julie Mix McPeak
Commissioner of Commerce
and Insurance
State of Tennessee
500 James Robertson Parkway
Nashville, Tennessee 37243

Dear Commissioner:

In accordance with the Tennessee Insurance Laws, regulations, and resolutions adopted by the National Association of Insurance Commissioners ("NAIC"), a financial examination and market conduct review has been made of the affairs and condition of

BLUECROSS BLUESHIELD OF TENNESSEE, INC.
1 CAMERON HILL CIRCLE
CHATTANOOGA, TENNESSEE 37402

hereinafter generally referred to as the Company, and a report thereon is submitted as follows:

SCOPE OF EXAMINATION

The Company was last examined as of December 31, 2005, by the State of Tennessee Department of Commerce and Insurance ("TDCI"). The current financial examination covers the intervening period to and including the close of business on December 31, 2010, and incorporated such subsequent events and transactions as were deemed pertinent to this report.

The examination was conducted in accordance with the NAIC Financial Condition Examiners Handbook and Tennessee Insurance Statutes. The Handbook requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company, including corporate governance, identifying and assessing inherent risks within the Company, and evaluating system controls and procedures used to mitigate those risks. The examination also includes assessments of the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management's compliance with Statutory Accounting Principles and annual statement instructions, when applicable to domestic state regulations.

The examination was called as of December 31, 2010. All original books and records

are kept at 1 Cameron Hill Circle, Chattanooga, Tennessee 37402.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process. The examination included the use of the Company's documentation of the Annual Financial Reporting Model Regulation (the Model Audit Rule) with regards to internal controls. It also included a review of workpapers prepared by Ernst & Young, the Company's independent auditors, in their examination of the Company's accounts for the year ended December 31, 2010.

The previous examination of the Company was made as of December 31, 2005, and resulted in no changes to the Company's surplus account. The examination did not result in any findings which required comments or recommendations.

COMPANY HISTORY

The Company was originally incorporated as the Tennessee Hospital Service Association under a charter dated September 10, 1945. It was organized under the authority, terms and provisions of Chapter 98 of the Public Acts of Tennessee of 1945, which governed the organization and conduct of non-profit hospital service corporations.

On June 9, 1949, the Company filed an amendment to its charter with the Secretary of State, State of Tennessee which added authority to provide medical expense indemnity benefits. This amendment had the effect of bringing the Company under Chapter 234 of the Public Acts of Tennessee of 1949. Provisions of the charter as amended were consistent with this latter statute and were approved by the Department of Insurance.

On November 29, 1968, the Company filed an amendment to its charter with the Secretary of State, State of Tennessee to have its name changed to BlueCross-BlueShield of Tennessee and later to BlueCross and BlueShield of Tennessee on April 8, 1974. On May 10, 1972, the Company filed an amendment with the Secretary of State, State of Tennessee to expand its services as follows:

To establish and operate a dental service plan under the terms of Section 56-3051 through 56-3532 of the Tennessee Code Annotated, to provide a vision service plan under the terms of Section 56-3071 through 56-3731 of the Tennessee Code Annotated, and to furnish and to administer such other services and plans, either along or in conjunction with one or more governmental agencies or other organizations, as may from time to time become available, all on a voluntary, nonprofit basis, and thereby to promote more fully the health and welfare of the people of the State of Tennessee.

On February 23, 1981, the members approved an amendment to the charter, which redefined the composition of the Board of Trustees. The amendment became effective January 12, 1982. The bylaws were revised to incorporate the charter amendment

effective September 1981. A charter amendment filed with the Secretary of State, State of Tennessee on May 29, 1985, changed the address of the principal office of the Company to BlueCross Building, 801 Pine Street, Chattanooga, Tennessee, 37402.

Effective January 1, 1996, the Company entered into an agreement to affiliate/combine with Memphis Hospital Service and Surgical Association ("MHSSA"), Memphis, Tennessee. Under the terms of the affiliation agreement, a holding company was formed for the purpose of serving as the sole member in the Company and in MHSSA. In connection with the affiliation, the Company changed its name to Chattanooga Hospital and Medical Service Association ("CHMSA") and the holding company became BlueCross and BlueShield of Tennessee, Inc.

Effective January 1, 1999, the operations of MHSSA were merged into CHMSA and the separate existence of MHSSA was discontinued. CHMSA was renamed BlueCross BlueShield of Tennessee, Inc. ("BCBST"). Simultaneously, the upstream holding company, also named BlueCross BlueShield of Tennessee, Inc. was dissolved.

Effective December 17, 2007, GDRG, LLC merged with and into BlueCross BlueShield of Tennessee, Inc. GDRG, formed in 2004, is a limited liability company whose primary purpose is to acquire, own, hold, maintain, operate, and develop real property.

The Company is a mutual benefit nonprofit corporation engaged primarily in providing health care programs and financial service products to group and individual customers. Health care financing products consist of preferred provider organizations, health maintenance organizations and point of service products. The Company provides indemnity health insurance coverage on a fully-insured basis and provides administrative services for self-funded health care plans.

The Company's development, since the previous examination, is depicted in the following table:

<u>Date</u>	<u>Enrolled Members</u>	<u>Total Revenues</u>	<u>Net Income</u>	<u>Admitted Assets</u>	<u>Surplus</u>
12/31/06	1,114,996	2,484,048,834	85,372,082	1,499,825,755	936,119,453
12/31/07	1,171,714	2,710,429,381	144,323,162	1,776,763,239	1,152,585,483
12/31/08	1,176,720	2,942,291,143	112,070,287	1,604,716,394	903,888,939
12/31/09	1,184,285	3,152,584,213	80,879,376	1,741,371,417	1,137,122,898
12/31/10	1,250,232	3,351,603,834	154,693,775	1,809,946,002	1,243,176,008

CHARTER AND BYLAWS

Charter:

The Company's charter was amended and restated as of January 1, 1999. The main provisions of the Charter are as follows:

- The name of the Company is BlueCross BlueShield of Tennessee, Inc.
- The duration of the Company is perpetual.
- The street address of the principal office of the Company in the State of Tennessee is 1 Cameron Hill Circle, Chattanooga, Tennessee 37402, County of Hamilton.
- The Company is not for profit.
- The Company is a mutual benefit company.
- The Company is formed for the purpose of establishing, maintaining and operating a nonprofit hospital and medical service company in accordance with the terms and provisions of Tenn. Code Ann. § 56-29-101 et. seq., as the same may be amended from time to time. In addition, the Company shall have and exercise all powers and authority necessary or convenient to carry on activities incidental to or associated with the purposes for which it is organized, and shall further possess all other powers and authority conferred upon companies generally under the Tennessee Nonprofit Company Act.
- A director of the Company shall not be personally liable to the Company for monetary damages for breach of fiduciary duty as a director, except for liability (i) for any breach of the director's duty of loyalty to the Company, (ii) for acts or omissions not in good faith, or which involve intentional misconduct or knowing violation of law, or (iii) for unlawful distributions under Tenn. Code Ann. § 48-58-304. If the Tennessee Nonprofit Company Act is amended after approval of this article to authorize corporate action further eliminating or limiting the personal liability of directors, then the liability of directors of the Company shall be eliminated or limited to the fullest extent permitted by the Tennessee Nonprofit Company Act, as so amended. Nothing in this paragraph shall relieve any director of any obligation imposed under Title 56 of the Tennessee Code Annotated.

All the general provisions and powers enumerated in the Company's charter are usual in nature and consistent with corporations of this type.

Bylaws:

The amended bylaws of the Company, dated December 3, 2010, are such as are generally found in corporations of this type. They are consistent with the charter and contain no unusual provisions. They provide for the regulation of the business and for the conduct of the affairs of the Company, the directors, committees and the officers. The bylaws may be altered, amended or repealed via a majority vote of the directors.

CORPORATE RECORDS

The minutes of the meetings of the Board of Directors were reviewed for the period under examination. They were found to be complete as to necessary detail and appear to adequately reflect the acts of the Board of Directors.

MANAGEMENT AND CONTROL

Board of Directors:

The administration and governance of the Company is vested in a Board of Directors which has charge, control and management of the business affairs, property and funds of the Company and which has the power and authority to do and perform all acts and functions consistent with its bylaws and applicable laws of the State of Tennessee and the United States.

The Company shall be managed by a Board of Directors composed of not less than 11 but no more than 17 members. The Board shall be at all times composed of the following groups: (1) administrators of hospitals which have contracted with the Company to render hospital service to the subscribers; (2) physicians, exclusive of group (1); and (3) the general public, exclusive of groups (1) and (2). Directors shall be selected so that at all times more than 50 percent of the members of the Board will be members of group (3), and the remaining positions of the Board shall be divided equally between members of groups (1) and (2).

At least four regular meetings of the Board of Directors shall be held during each calendar year. The annual meeting shall be held prior to the last day of April of each year, and the other regular meetings shall be held each year on dates to be fixed by the Board of Directors. At all meetings of the Board of Directors a majority of the Directors shall be necessary to constitute a quorum for the transaction of business, and the act of the majority of Directors present at any meeting at which a quorum is present shall be the act of the Board of Directors. Directors may take any action that they are required or permitted to take by law, without a meeting, by written consent, setting forth the action so taken, signed by all persons entitled to vote thereon.

Directors will be elected by the Board of Directors at the annual meeting of the Board of Directors to replace Directors whose terms are expiring. The Governance and Nominating Committee of the Board of Directors has the responsibility for the presentation of its slate of nominees for membership on the Board of Directors at the annual meeting. The slate of nominees shall include nominees to fill the position for all Directors whose terms shall expire at that annual meeting. Directors will be elected to serve a three year renewable term. Mandatory retirement age for Board members shall be 70 years. Board members turning 70 during their terms may complete the remainder of their term but may not be renominated. Any Director may resign at any time by giving written notice to the Secretary of the Company. Directors may be removed from office at any time, with or without cause, by a majority vote of the Board of Directors. Vacancies on the Board of Directors caused by death, resignation, removal or any other cause creating an open and unexpired position will be filled by a Director nominated and elected in accordance with the procedure followed to replace a Director whose term has expired.

Directors may be compensated in an amount not to exceed that permitted by law. The

Compensation Committee shall consider what constitutes appropriate compensation and make a recommendation to the Board as to the amount and dates upon which each Board member shall be paid. In addition, the Directors of the Company may receive payment for particular services actually rendered, such as legal counsel, medical service, accounting or other required services, upon specific approval of the Board of Directors; provided, however, that no contract for equipment or supplies may be entered into between this Company and one or more Board members unless such contract is approved in accordance with the Company's Code of Conduct and Tenn. Code Ann. § 48-58-302.

At December 31, 2010, the following persons were serving as members of the Board of Directors:

<u>Name</u>	<u>Address</u>	<u>Occupation</u>
Hulet M. Chaney	Knoxville, TN	Retired (former CEO of TN Farmers Ins. Companies)
Gus B. Denton	Memphis, TN	Sec. of the Board SunTrust
Betty W. DeVinney	Kingsport, TN	Retired (former SVP Eastman Chemical)
Vicky B. Gregg	Chattanooga, TN	CEO and President of BCBST
Herbert H. Hilliard	Eads, TN	Exec. VP of First TN Bank
Lamar J. Partridge	Chattanooga, TN	President of Valley Capital Corp.
James M. Phillips	Rogers, AR	CEO and Managing Partner of Pinnacle Investments
Gloria S. Ray	Knoxville, TN	President and CEO of KTSC
Emily J. Reynolds	Nashville, TN	Senior VP of Communications and Government & Valley Relations of Tennessee Valley Authority
Paul E. Stanton, Jr.	Johnson City, TN	President of East TN State University
Scott E. Wallace	Oak Park, IL	Batten Fellow at the University of Virginia's Darden School of Business

Officers:

The officers of the Company shall be elected by the Board of Directors at the annual meeting and shall hold office for one year or until their death, removal, resignation or retirement. Vacancies may be filled at any time by the Board of Directors. The officers shall consist of a Chairman, a Vice Chairman, a Chief Executive Officer, a President, a Secretary and a Treasurer. The Secretary and Treasurer may be one person. The Board of Directors may also at its discretion appoint administrative officers in addition to those set forth above, upon the recommendation of the Chief Executive Officer. Such officers shall not be members of the Board of Directors, each of whom shall serve at the pleasure of the Chief Executive Officer.

The Chairman of the Board of Directors shall preside at all meetings of the Board of Directors and of the Executive and Governance Committee. The Vice Chairman, in the absence of the Chairman, shall perform the duties of the Chairman, and shall perform such other duties as may be prescribed by the Board of Directors. The Chief Executive Officer shall be responsible for the day-to-day management of the business of the Company and shall make a good faith effort to implement all policies and resolutions of the Board of Directors, shall have the general powers and duties of supervision and management of the Company which usually pertain to this office and shall perform such other duties as may from time to time be prescribed by the Board of Directors. The President shall have general supervision of the affairs of the Company, subject to the direction of the Board of Directors and the Chief Executive Officer. In the absence of the Chief Executive Officer, the President shall perform the duties of the Chief Executive Officer, and shall perform such other duties as may be prescribed by the Chief Executive Officer or the Board of Directors. The Secretary shall be the legal custodian of all the books and records of the Company, shall keep the minutes of the meetings of the Board of Directors and shall prepare the annual reports of the Company. Any of such duties may be delegated by the Board of Directors to an Assistant Secretary or other officer or employee of the Company. The Treasurer shall be the legal custodian of all moneys of the Company and shall present at each annual meeting of the Board of Directors a statement of the receipts and disbursements during the previous year. He shall be permitted to delegate the responsibilities of custody and reports to the Chief Financial Officer or to such other adequately bonded employee as Treasurer or the Board of Directors may designate. The Treasurer shall however, personally, annually procure and present the report of the auditors of the Company to the Board of Directors.

At December 31, 2010, the following persons had been duly elected to and were serving in the positions indicated:

<u>Name</u>	<u>Office Held</u>
Vicky Gregg	Chief Executive Officer
Bill Gracey	President & Chief Operating Officer
Danny Timblin	Treasurer
Alaine Zachary	Assistant Treasurer

Shelia Clemons
Jill Oaks

Secretary
Assistant Secretary

Committees:

The Board of Directors may create, from time to time, standing or special committees, as it shall deem necessary or appropriate. Members of committees may be Directors or other natural persons appointed in accordance with Tenn. Code Ann. § 48-58-206. No committee shall have the authority to amend, alter, or repeal the Bylaws; elect, appoint or remove any member of any such Committee or any Director or any officer of the Company; amend the Charter, adopt a plan of merger or adopt a plan of consolidation with another Company; or amend, alter or repeal any resolution of the Board of Directors. At December 31, 2010, the standing committees of the Board of Directors and respective committee members were as follows:

- Executive Committee - This Committee has the Board of Directors authority to address emergency issues between scheduled meetings of the Board.

Lamar Partridge (Chair)
Gloria Ray
Gus Denton
Hulet Chaney

Betty DeVinney (Vice Chair)
Herbert Hilliard
Scott Wallace

- Audit Committee - This Committee will assist the Board in fulfilling its duties by overseeing the Company's financial reporting and control activities, and the Compliance and Code of Conduct Programs.

Scott Wallace (Chair)
Hulet Chaney

Herbert Hilliard

- Compensation Committee - Establishes and oversees the officers' compensation philosophy which includes the basic statement of strategy, policy and components of compensation and benefits, including applicable incentive programs and implementation of such programs and policies.

Gloria Ray (Chair)
Emily Reynolds

Hulet Chaney
Betty DeVinney

- Public Policy Committee - This Committee shall oversee and establish policies related to the Company's government relations activities, and oversight of the BCBST Health Foundation and BCBST Community Trust.

Hulet Chaney (Chair)
Gloria Ray

Emily Reynolds
Paul Stanton

- Finance Committee - This Committee shall assist the Board in fulfilling its duties by exercising effective oversight of finance and investment activities.

Gus Denton (Chair)
Jim Phillips

Scott Wallace

- Governance and Nominating Committee – This Committee has the duties of overseeing corporate governance and recruiting and nominating new Board Members.

Herbert Hilliard (Chair)
Jim Phillips

Gus Denton
Paul Stanton

Conflict of Interests:

All Directors and officers of the Company are required to complete an Annual Conflict of Interest Statement. The examiners reviewed the statements signed by the Company's directors and officers, for the period under examination, without exception.

Pecuniary Interest:

A check for compliance with Tenn. Code Ann. § 56-3-103 found that no director or officer of the Company had pecuniary interest in the investment or disposition of Company funds.

AFFILIATED COMPANIES

The Company has established or acquired subsidiaries as further detailed below:

Southern Health Plan, Inc. ("SHP")

SHP was incorporated on January 30, 1980. SHP is a not-for-profit, social welfare organization. It does business as BlueCross BlueShield of Tennessee Community Trust (the "Trust") and is an affiliate of the Company. The Trust is a tax-exempt entity operating as a 501(c)(4) for the purpose of supporting programs that improve the quality of life in Tennessee, particularly those programs that promote good health and improve the availability, accessibility and quality of health care for the people of Tennessee. The Company appoints the SHP Board of Directors.

Tennessee Health Foundation, Inc. ("THF")

THF was incorporated on September 25, 2003. THF is a not-for-profit, public benefit corporation that promotes charitable activities, doing business as BlueCross BlueShield of Tennessee Health Foundation. THF is an independent licensee of the BCBSA, licensed as a charitable foundation. The Internal Revenue Service has granted THF a 501(c) (3) tax exemption, and THF operates as a private foundation. The Company appoints the Board of Directors.

BeneVive, Inc.

BeneVive was incorporated on November 13, 2006. BeneVive is a for-profit, wholly owned downstream holding company of the Company. The principal activity of BeneVive is holding stock of Onlife Health, Inc., Shared Health, Inc., RiverTrust Solutions, Inc. and Riverbend Government Benefits Administrator, Inc. BeneVive also appoints the Board of Directors for Onlife Health, Shared Health, RiverTrust Solutions and Riverbend Government Benefits Administrator, Inc. The Company is the sole stockholder of BeneVive and appoints the BeneVive Board of Directors.

Onlife Health, Inc. ("OLH")

OLH was incorporated in 1996. OLH is a for-profit, wholly owned subsidiary of BeneVive. OLH is a population health risk management company with operations in Franklin, Tennessee. OLH is a national personal health coaching company. OLH's approach is designed to create trusted relationships that inspire and guide people to make lasting lifestyle changes that lead to improved health. OLH does business as Gordian Health Solutions in New Hampshire. BeneVive is the sole stockholder of OLH and appoints the OLH Board of Directors.

Shared Health, Inc. ("SH")

SH was incorporated on April 28, 2005. SH is a for-profit, wholly owned subsidiary of BeneVive and was established to help transform Tennessee's health care by offering secure, innovative health information technology solutions. SH works with patients, doctors, employers, and insurers to improve quality and efficiency through innovative technological solutions that give both consumers and clinicians vital medical information from a single secure online source. BeneVive is the sole stockholder of SH and appoints the SH Board of Directors.

RiverTrust Solutions, Inc. ("RTS")

RTS was incorporated on December 12, 2003. RTS is a for-profit, wholly-owned subsidiary of BeneVive. RTS was established for the purpose of performing business activities under the Centers for Medicare & Medicaid Services ("CMS") Qualified Independent Contractor contract and any task orders issued under that contract. BeneVive is the sole stockholder of RTS and appoints the RTS Board of Directors. RTS is not currently conducting any business.

Riverbend Government Benefits Administrator, Inc. ("RGBA")

RGBA was incorporated on October 25, 2002. RGBA is a for-profit, wholly owned subsidiary of BeneVive. RGBA was the subcontractor to CGS under CGS's Medicare Administrative Contractor contract. BeneVive is the sole stockholder of RGBA and appoints the RGBA Board of Directors.

Security Care, Inc. ("SC")

SC was incorporated on July 28, 2004 and was dissolved on November 2, 2011. SC was a for-profit, wholly owned subsidiary of BeneVive. SC provided innovative services to protect the financial integrity of healthcare programs. The mission was to be a

preeminent partner to public and private financiers of healthcare services by providing an innovative, effective, and efficient approach to performing fraud prevention, detection and investigation. SC was a subcontractor on a Compromised Number Contractor for CMS. BeneVive was the sole stockholder of SC and appointed the SC Board of Directors.

Southern Diversified Business Services, Inc. ("SDBS")

SDBS was incorporated on July 9, 1982. SDBS is a for-profit, wholly-owned downstream holding company of the Company. The principal activity of SDBS is holding stock of GIS, GSIC, and VSHP. SDBS also appoints the Board of Directors for GIS, GSIC, and VSHP. The Company is the sole stockholder of SDBS and appoints the SDBS Board of Directors.

Volunteer State Health Plan, Inc. ("VSHP")

VSHP was incorporated on July 1, 1996. VSHP is a wholly-owned subsidiary of SDBS. It is a Tennessee for-profit corporation, and it is licensed as a Health Maintenance Organization (HMO) in the State of Tennessee and does business as BlueCare. VSHP is an independent licensee of BCBSA, licensed as a large affiliate. The Company has a Guaranty Agreement with VSHP whereby the Company agrees to fund VSHP's RBC and liquidity ratio requirements. During 2010, the Company transferred \$79.0 million under the agreement as additional capital contributions and issued two surplus notes totaling \$17.0 million. SDBS is the sole stockholder of VSHP and appoints the VSHP Board of Directors.

Group Insurance Services, Inc. ("GIS")

GIS was incorporated on January 9, 1964. GIS is a for-profit, wholly-owned subsidiary of SDBS. GIS acts as a broker for the Company and other life insurance companies in the State of Tennessee. GIS provides a full range of ancillary coverage to complement employer sponsored health plans, stand-alone insurance products, combined group medical-hospitalization insurance, group processing services and group life insurance. SDBS is the sole stockholder of GIS and appoints the GIS Board of Directors.

Golden Security Insurance Company, Inc. ("GSIC")

GSIC was incorporated on December 14, 1982. GSIC is a for-profit, wholly-owned subsidiary of SDBS. GSIC offers policies for specific and aggregate medical stop-loss coverage, doing business as BlueRe of Tennessee. BlueRe of Tennessee is an independent licensee of BCBSA, licensed as a small affiliate. SDBS is the sole stockholder of GSIC and appoints the GSIC Board of Directors.

The Company maintains administrative services agreements with GIS, GSIC, OLH, RGBA, RTS, SH, SHP, VSHP and BCBST Credit Union. For GIS, OLH, RGBA, RTS, SH, VSHP and BCBST Credit Union, certain administrative services are provided by the Company. Each entity reimburses the Company for the direct costs incurred. Indirect and allocated costs are allocated within a calculated fee.

Under the agreements with SHP and GSIC, the Company supervises and manages the day to day operations which include the administrative services of each entity. GSIC reimburses the Company as described above. The Company is reimbursed by SHP for the fully allocated service costs calculated by the Company.

A tax allocation agreement exists for the Company and the subsidiaries. The Company files a consolidated income tax return. Each subsidiary is allocated its portion as if it filed an individual return.

An organizational chart is attached to this report on page 29.

FIDELTIY BOND AND OTHER INSURANCE

The Company's major coverages and limits, as of December 31, 2010, are as follows:

<u>Type or Class of Coverage</u>	<u>Limits</u>
Financial Institution Bond	\$10,000,000 Aggregate \$5,000,000 Fidelity
Fiduciary Liability	\$10,000,000 Each Claim
Commercial Property	\$299,000,000 Headquarters Property \$31,000,000 Business Income \$10,000,000 Extra Expense
Crime	\$5,000,000 Aggregate Limit
Commercial General Liability	\$2,000,000 General Aggregate \$1,000,000 Personal Injury \$2,000,000 Products Aggregate \$1,000,000 Each Occurrence \$10,000 Medical Expenses \$1,000,000 Rented Premises
Automobile Liability	\$1,000,000 Combined Single Unit
Excess Liability – Umbrella Form	\$10,000,000 Each Occurrence
Workers' Compensation	\$10,000,000 Aggregate \$500,000 Each Accident \$500,000 Disease – Each Employee \$500,000 Disease – Policy Limit
Directors' and Officers' Liability	\$10,000,000 Aggregate
Excess Liability	\$30,000,000 Aggregate
Aircraft Liability	\$100,000,000 Liability Limit
Managed Care Liability	\$10,000,000 Overall Policy Agg. \$2,000,000 SIR
Internet Liability	\$10,000,000 Aggregate \$500,000 SIR
Primary Healthcare Facilities	\$1,000,000 Each Property

Incident Professional Liability

\$3,000,000 Pro. Liability Agg. Limit

The fidelity coverage is in excess of the suggested minimum amount per the NAIC Financial Condition Examiners Handbook. All of the above insurance policies are written by companies licensed to write in Tennessee.

EMPLOYEE BENEFITS

Employees are entitled to the following benefits which were provided by the Company during the period of examination:

Insurance Benefits:

1. Term life insurance is provided on a non-contributory basis at an amount two times the employee's total compensation.
2. Health insurance is provided whereby the employee chooses between a high deductible health plan with a health savings account, a high deductible health plan with a health reimbursement arrangement or a PPO plan. Employees contribute premiums for individual, employee plus or family coverage. Non-participation in a wellness program can increase medical premiums by \$25. Vision benefits are included at no cost for employees enrolled with medical coverage. Dental benefits are also provided.
3. Workers' compensation is provided to all employees.
4. Short-term disability is provided to all employees on a non-contributory basis.
5. Long-term disability is provided to all employees on a non-contributory basis. The Company also has additional long-term disability coverage on a premium basis.

Retirement Plan:

The Company maintains defined benefit and defined contribution plans.

The defined benefit plans are as follows:

- A qualified pension plan covers employees hired prior to July 1, 2006, and excludes employees of the subsidiary OLH. This plan is part of a noncontributory defined benefit retirement program.
- The postretirement health benefits program is for the Company's retired employees who were hired before January 1, 2005.
- A Supplemental Executive Retirement Plan ("SERP") provides benefits for certain executives and highly compensated employees whose benefits under the defined benefit pension plan are restricted by the limitations of sections 401(a)(17) and 415 of the Internal Revenue Code.

The defined contribution plans are as follows:

- The BlueCross BlueShield of Tennessee Employee Retirement Savings Program ("BCBST 401(k)") is a 401(k) retirement savings plan which covers substantially

all of the Company's employees. Participants may contribute up to 50% of eligible compensation not to exceed \$16,500 for 2010. The Company provides matching contributions based on a percentage of employee contributions.

- The BCBST Retirement Accumulation Program ("RAP") is separate from the BCBST 401(k) plan and covers substantially all of the Company's employees. All contributions are made by the Company and 3.5% of the employee's eligible compensation is contributed into the employee's RAP account up to a maximum eligible compensation limit.
- The BCBST Restoration Supplemental Executive Retirement Plan ("Restoration SERP") covers certain executives or highly compensated employees who are participating in the BCBST 401(k) and RAP. The Restoration SERP plan is unfunded. Each year, the Company determines the contributions to the Restoration SERP based on what would have been made to the Participant's 401(k) plan and RAP account without any imposed IRS limitations.

TERRITORY

The Company is licensed in the State of Tennessee only and operates in all counties. The Company is headquartered in Chattanooga, with regional offices in Jackson, Johnson City, Knoxville, Memphis and Nashville. The Certificate of Authority issued by the State of Tennessee was inspected and found to be in force both at the time of examination and inspection.

The Company services group and individual (direct pay) business in states other than Tennessee, including Georgia and Alabama. Direct pay individual contracts generating premiums in other states were written on other state residents who personally applied for coverage at the Company's home office, or were residents of Tennessee when coverage was written.

PLAN OF OPERATION

Funds received and disbursed by the Company are divided between insured products and self-funded products. The major segments of these products are discussed as follows under those appropriate headings.

Insured Products:

The Company issues health coverage on an Individual and group basis. Subscribers are enrolled by Company employee account sales and account executives and by independent brokers. Each individual subscriber is issued a policy. In group coverage, underwriting and collection of premiums is on a group basis. When a group member loses eligibility, he or she may be eligible for conversion to individual coverage.

The Company is an independent not-for-profit health plan headquartered in Tennessee and is a licensee of the BlueCross BlueShield Association, an association of

independent BlueCross and BlueShield plans.

The Company contracts with hospitals, physicians and other medical providers (called network providers) to provide services to Plan members. Each member is issued an identification card, recognized by doctors, hospitals and other providers nationwide. Services are covered as specified by the member's individual policy or group contract.

Covered services generally include:

- Practitioner office services
- Hospital emergency care services
- Outpatient facility services
- Family planning and reproductive services
- Skilled nursing facility and rehabilitation facility services
- Organ transplants
- Diagnostic services
- Durable medical equipment, prosthetics and orthotics
- Home health care services
- Inpatient hospital services
- Ambulance services
- Behavioral health services
- Reconstructive surgery
- Dental and oral surgery services for accidental injury
- Therapeutic/rehabilitative services
- Prescription drugs
- Medical supplies
- Hospice services

Health Care Management Programs

The Company provides services to help manage members' care including performing prior authorization of certain services to ensure they are medically necessary, concurrent review of hospitalization, discharge planning, lifestyle and health education, low-risk case management, catastrophic medical and transplant case management and the development and publishing of medical policy. The Company does not make medical treatment decisions under any circumstances. Members may elect to receive services that do not comply with the Company's health care management requirements or medical policy, but doing so may affect the coverage of such services.

Other Insured Products

- Individual and Group Dental Coverage
- Medicare Supplement Products - This program provides supplemental benefits for persons 65 years of age and over who enrolled in Medicare Part A and Part B. The program covers hospital deductibles and coinsurance not provided for by Medicare, physician coinsurance, and other benefits according to contracts filed with and approved by the TDCI.
- Medicare Advantage Plans - BlueAdvantage covers the same types of services that Original Medicare covers, plus some additional services not covered by Original Medicare. Plans offered by the Company include medical only and medical and prescription drug coverage.
- Medicare Part D Prescription Drug Plan - Medicare prescription drug coverage is insurance that covers both brand-name and generic prescription drugs at participating pharmacies. Medicare prescription drug coverage provides protection for members who have very high drug costs or from unexpected prescription drug bills in the future. The BlueRx plans are operated as a joint venture with BlueCross BlueShield of Alabama.
- Reinsurance for self-funded plans.

Self-Funded Products

Self-funded clients contract with the Company for administration of health, dental or other benefits. The client assumes the risk for claims paid on behalf of eligible members, and pays the Company a fee for administrative services provided.

Listed below is a tabulation of the Company's 2010 direct premiums written in Tennessee.

Comprehensive (hospital and medical)	\$2,275,987,828
Medicare Supplement	134,594,444
Dental only	79,365,197
Vision only	1,596,952
Federal Employees Health Benefits Plan	380,622,023
Title XVIII – Medicare	456,778,012
Other Health	<u>26,517,445</u>
Totals	\$3,355,461,901

MARKET CONDUCT ACTIVITIES

Underwriting

The Company uses a series of in-house underwriting manuals that were provided electronically in "read only" Microsoft Word format for underwriter and agent use with changes posted on a quarterly basis as needed. All underwriting manuals were reviewed and found to be easily navigated and user friendly. The information provided is presented in an organized and understandable format for underwriter and agent use

in determination of acceptable risk.

In the examination of Company underwriting procedures, thirty nine (39) open and thirty nine (39) terminated health plans were reviewed in accordance with statutory requirements of Tenn. Code Ann. § 56-8-104 (Unfair methods of competition and unfair or deceptive acts or practices defined), Tenn. Comp. R. & Reg., ch. 0780-1-34 (Eliminating Unfair Discrimination) and established Company guidance. In the examination of the above health plans, no instances of unfair methods of competition or unfair or deceptive acts were found and underwriting procedures and policy administration appear in compliance with the Company's established underwriting guidance.

Company Grievance Procedures:

The Company's grievance procedures were reviewed in accordance with requirements of Tenn. Code Ann. § 56-61-105 through 108 and disclosure requirements of Tenn. Code Ann. § 56-61-125. The Company's grievance log, written procedures, and files were examined and found to be in compliance with statutory requirements.

In the examination of grievances received during the period under examination, a sample of forty four (44) files was selected for examination. All files in the sample were examined in accordance with level 1 and level 2 review requirements as listed in the statutes. The Company's level 1 and level 2 review processing time was determined from the sample to be in compliance with the "no later than" statutory processing time with one level 2 exception as noted below:

Grievance Review Process	Statutory "no later than"	Company Average
Level 1 Processing Time (Dates)		
Prospective Review Request	30 Days	25.4 Days
Retrospective Review Request	60 Days	41.1 Days
Level 2 Processing Time (Dates)	60 Days	*66.0/46.7 Days

(*)One level 2 grievance file in the sample had extenuating medical issues requiring longer processing time of 124 days. However, since the 60 day statutory requirement for level 2 processing was enacted in 2010 and the file in question was from 2008 the Company is in compliance. If this file is removed from the calculation, the level 2 average would be 46.7 days.

Policy Rate and Form Filings

Thirty nine (39) policy rate and form filings were selected for examination in compliance with filing requirements of Tenn. Code Ann. § 56-26-102 (a) (1) and 56-26-202 (a). In examination of the filings, it was found that all Company filings were filed with the Department, prior to their use, in accordance with the statutory requirement. In addition, the policy rates and forms in the sample were traced without exception to active health insurance policies examined during the underwriting portion of the examination. The Company's filings are consistent in form and well documented.

Advertising

In the examination of Company advertising, all advertising items to include print, internet and television materials issued by the Company were examined in accordance with Tenn. Code Ann. § 56-8-104 (1) (Unfair methods of competition and unfair or deceptive acts or practices defined - False Information and Advertising) and the NAIC Market Regulation Handbook (Chapter 16 - Marketing and Sales). Twenty one (21) items were selected and examined in accordance with the statute with no exceptions found. The Company, which uses the advertising brand standards as established by the BlueCross BlueShield Association, was found to have strong controls in place for the production and use of all advertising materials with only company approved materials authorized for use.

GROWTH OF THE COMPANY

The following comparative data reflects the growth of the Company for the period under review (000's omitted)

	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>
Admitted assets	1,499,826	1,776,763	1,604,716	1,741,371	1,809,946
Total liabilities	563,706	624,178	700,827	604,249	566,770
Statutory Surplus	614,369	682,130	755,686	834,678	918,565
Net underwriting gain	98,238	138,852	168,562	99,197	128,014
Net investment gain	67,291	106,676	19,879	23,596	73,738
Net income	85,372	144,323	112,070	80,879	154,694

LOSS EXPERIENCE

The loss experience of the Company, since the previous examination, as reported in its annual statements, is as follows:

<u>Year</u>	<u>Total Revenues</u>	<u>Total Hospital and Medical Expenses</u>	<u>Medical Loss Ratio</u>	<u>Total Administrative Expenses</u>	<u>Combined Ratio</u>
2006	\$2,484,048,834	\$2,109,712,625	84.9%	\$261,468,104	95.5%
2007	2,710,429,381	2,212,781,984	81.6%	345,507,472	94.4%
2008	2,942,291,143	2,405,073,209	81.7%	373,484,137	94.4%
2009	3,152,584,213	2,609,012,940	82.8%	444,396,465	96.9%
2010	<u>3,351,603,834</u>	<u>2,783,483,126</u>	<u>83.0%</u>	<u>440,174,974</u>	<u>96.2%</u>
Total	<u>\$14,640,957,405</u>	<u>\$12,120,063,884</u>	<u>82.8%</u>	<u>\$1,865,031,152</u>	<u>95.5%</u>

STATUTORY DEPOSITS

The Company is qualified as a self-insurer under the Workers Compensation Act of Tennessee. As a self-insurer, the Company had a special deposit, as of December 31,

2010, which is not held for the benefit of all policyholders, claimants and creditors of the Company.

<u>Where Deposited and Description</u>	<u>Par Value</u>	<u>Statement Value</u>	<u>Market Value</u>
Tennessee USTN, 0.5%, Due 10/15/13	\$350,000	\$349,639	\$346,091

The above deposit was verified by direct correspondence with the regulating jurisdiction.

COMMITMENTS AND CONTINGENCIES

From the examination data made available, it appears that the only matters of law in which the Company was involved, during the period under review, were those arising out of the normal course of business and the outcome of such actions should not have a material effect on the financial position of the Company.

ACCOUNTS AND RECORDS

During the course of examination, such tests and audit procedures were made as were considered necessary, including verification of postings, extensions and footings. Accounting records conform to generally accepted insurance accounting practices and appear to properly reflect the operations during the period under examination and the status of the Company at the date of examination.

The Company is audited annually by Ernst & Young LLP, Chattanooga, Tennessee. There is no violation as respects Tenn. Comp. R. & Reg., ch. 0780-1-65.07(3).

The Company's Risk-Based Capital Report was reviewed and found to be in compliance with Tenn. Code Ann. § 56-46-101, et seq.

The standards set in Tenn. Code Ann. § 56-7-109 for electronic and paper claims were met by the Company in each of the years reviewed.

ACTUARIAL REVIEW

Lewis & Ellis, Inc., Actuaries and Consultants, Richardson, Texas performed an assessment of the actuarial liabilities and reserves as of December 31, 2010. Specifically, the following accounts were reviewed:

Claims unpaid	Aggregate health policy reserves
Unpaid claims adjustment expenses	

Based on their analysis, the Company is holding adequate liabilities and their methodology is appropriate for the lines of business.

SUBSEQUENT EVENTS

Security Care, Inc. was dissolved on November 2, 2011.

In February 2012, the Company announced the planned retirement of Vicky Gregg effective December 31, 2012. William M. Gracey will replace Mrs. Gregg as Chief Executive Officer.

The Company began implementing provisions of the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010. The phased rollout of the provisions will cause new risks and uncertainties. Health insurers must meet minimum Medical Loss Ratios ("MLR"). The MLR standards require health insurers to spend a minimum level of premium revenue on clinical services and activities to improve health care quality. If the minimum level of spending is not met, an insurer will be required to issue rebates to plan members. The Company will be issuing rebates to individual subscribers in 2012.

FINANCIAL STATEMENT

There follows a statement of assets, liabilities and statement of revenue and expenses at December 31, 2010, together with a reconciliation of reserves and unassigned funds for the period under review, as established by this examination:

ASSETS

	<u>Assets</u>	<u>Nonadmitted Assets</u>	<u>Net Admitted Assets</u>
Bonds	\$ 835,462,387	\$ 0	\$ 835,462,387
Stocks:			
Preferred stocks	7,551,062	2,000,000	5,551,062
Common stocks	332,549,025	124,764,029	197,784,996
Real estate	106,803,460	0	106,803,460
Cash, cash equivalents and short term investments	222,415,153	0	222,415,153
Other invested assets	178,671,981	29,405,603	149,266,378
Receivables from securities	<u>610,400</u>	<u>380,000</u>	<u>230,400</u>
Subtotals, cash and invested assets	<u>1,674,063,468</u>	<u>156,549,632</u>	<u>1,517,513,836</u>
Investment income due and accrued	9,254,503	0	9,254,503
Premiums and considerations:			
Uncollected premiums and agents' balances in the course of collection	26,036,260	1,164,788	24,871,472
Deferred premiums, agents' balances and installments booked but deferred	55,784,860	0	55,784,860
Accounts receivable relating to uninsured plans	91,330,404	7,290,789	84,039,615
Current federal & foreign income tax income tax recoverable and interest thereon	19,598,176		19,598,176
Net deferred tax asset	56,636,269	11,764,515	44,871,754
Guaranty funds receivable or on deposit	1,734,359	0	1,734,359
Electronic data processing equipment	71,345,314	60,690,803	10,654,511
Furniture and equipment	49,815,333	49,815,333	0
Receivables from parent, subsidiaries and affiliates	34,326,435	4,318,724	30,007,711
Health care and other amounts receivable	32,525,197	23,959,992	8,565,205
Aggregate write-ins for other than invested assets:			
Pension benefit/Retiree health asset	102,693,411	102,693,411	0
Prepaid and Miscellaneous	31,499,430	31,499,430	0
Split dollar retirees life insurance surrender value	4,235,016	4,235,016	0
TN Investco State Tax Credits	<u>3,050,000</u>	<u>0</u>	<u>3,050,000</u>
Total assets	<u>\$2,263,928,435</u>	<u>\$453,982,433</u>	<u>\$1,809,946,002</u>

LIABILITIES, CAPITAL AND SURPLUS

	Covered	Uncovered	Total
Claims unpaid	\$ 296,437,056	\$ 0	\$ 296,437,056
Unpaid claims adjustment expenses	10,009,645	0	10,009,645
Aggregate health policy reserves	19,849,770	0	19,849,770
Premiums received in advance	29,826,570	0	29,826,570
General expenses due or accrued	53,069,068	0	53,069,068
Current federal income tax payable	7,008,667	0	7,008,667
Amounts withheld or retained for account of others	79,682,406	0	79,682,406
Remittance and items not allocated	9,035,257	0	9,035,257
Borrowed money	962,138	0	962,138
Payable for securities	6,817	0	6,817
Liability for amounts held for uninsured plans	50,992,945	0	50,992,945
Aggregate write-ins for liabilities:			
Pending escheatment to state	8,671,095	0	8,671,095
Fixed Payer LIBOR SWAP Hedge Against Debt	<u>1,218,560</u>	<u>0</u>	<u>1,218,560</u>
Total liabilities	<u>566,769,994</u>	<u>0</u>	<u>566,769,994</u>
Aggregate write-ins for special surplus funds:	XXX	XXX	
Statutory reserves required	XXX	XXX	918,565,116
Unassigned funds	XXX	XXX	<u>324,610,892</u>
Total capital and surplus	XXX	XXX	<u>1,243,176,008</u>
Total liabilities, capital and surplus	XXX	XXX	<u>\$1,809,946,002</u>

STATEMENT OF REVENUE AND EXPENSES

	<u>Uncovered</u>	<u>Total</u>
Member months	XXX	14,784,827
Net premium income	XXX	\$3,355,461,901
Change in unearned premium reserves	XXX	<u>(3,858,067)</u>
Total revenues	XXX	3,351,603,834
Hospital and Medical:		
Hospital/medical benefits	0	2,161,334,052
Other professional services	0	215,740,439
Prescription drugs		<u>406,408,635</u>
	<u>0</u>	
Subtotal	0	2,783,483,126
Less:		
Net reinsurance recoveries		<u>0</u>
	<u>0</u>	
Total hospital and medical	0	2,783,483,126
Claims adjustment expenses	0	162,109,755
General administrative expenses		278,065,219
	0	
Increase in reserves for life and a&h contracts	0	<u>(68,265)</u>
Total underwriting deductions		<u>3,223,589,835</u>
	<u>0</u>	
Net underwriting gain or (loss)	XXX	128,013,999
Net investment income earned	0	37,533,867
Net realized capital gains or (losses) net of tax		<u>36,204,165</u>
	<u>0</u>	
Net investment gains or (losses)	0	73,738,032
Aggregate write-ins for other income or expenses:		
Charitable contribution to Tennessee Health Foundation		<u>(10,000,000)</u>
	<u>0</u>	
Net income or (loss) before federal income taxes	XXX	<u>191,752,031</u>
Federal income taxes incurred	XXX	<u>37,058,256</u>
Net income (loss)	XXX	<u>\$ 154,693,775</u>

RECONCILIATION OF RESERVES AND UNASSIGNED FUNDS
FOR THE PERIOD UNDER EXAMINATION

Capital and Surplus, December 31, 2005	\$ 907,948,194
Net income	85,372,082
Change in net unrealized capital gains or (losses)	20,607,734
Change in net deferred income tax	48,314,203
Change in nonadmitted assets	(92,132,638)
Cumulative effect of changes in accounting principles	(33,928,422)
Change in additional minimum pension liability	<u>(70,700)</u>
Net change in capital and surplus for the year	<u>28,171,259</u>
Capital and Surplus, December 31, 2006	<u>\$ 936,119,453</u>
Net income	144,323,162
Change in net unrealized capital gains or (losses)	26,404,829
Change in net deferred income tax	22,735,827
Change in nonadmitted assets	26,293,952
Cumulative effect of changes in accounting principles	(4,020,701)
Change in additional minimum pension liability	<u>728,961</u>
Net change in capital and surplus for the year	<u>216,466,030</u>
Capital and Surplus, December 31, 2007	<u>\$ 1,152,585,483</u>
Net income	112,070,287
Change in net unrealized capital gains or (losses)	(216,993,878)
Change in net deferred income tax	107,455,811
Change in nonadmitted assets	(213,413,891)
Change in additional minimum pension liability	<u>(37,814,873)</u>
Net change in capital and surplus for the year	<u>(248,696,544)</u>
Capital and Surplus, December 31, 2008	<u>\$ 903,888,939</u>
Net income	80,879,376
Change in valuation basis of aggregate policy and claim reserves	75,519,313
Change in net unrealized capital gains or (losses)	37,007,362
Change in net deferred income tax	(71,854,741)
Change in nonadmitted assets	99,324,753
Change in additional minimum pension liability	<u>12,357,896</u>
Net change in capital and surplus for the year	<u>233,233,959</u>
Capital and Surplus, December 31, 2009	<u>\$ 1,137,122,898</u>
Net income	154,693,775
Change in valuation basis of aggregate policy and claim reserves	0
Change in net unrealized capital gains or (losses)	(25,466,615)
Change in net deferred income tax	(35,947,177)
Change in nonadmitted assets	(2,511,539)
Aggregate write-ins for gains or (losses) in surplus:	
Change in additional minimum pension liability	25,456,977
Correction of Presentation – Reporting Deferred Acquisition Costs	<u>(10,172,311)</u>
Net change in capital and surplus for the year	<u>106,053,110</u>
Capital and Surplus, December 31, 2010	<u>\$ 1,243,176,008</u>

ANALYSIS OF CHANGES IN FINANCIAL STATEMENT AND COMMENTS
RESULTING FROM EXAMINATION

None.

COMMENTS AND RECOMMENDATIONS

The examination did not result in any findings which require comments or recommendations.

CONCLUSION

The customary insurance examination practices and procedures, as established by the NAIC, have been utilized in connection with the verification and valuation of assets and the determination of liabilities in the financial statement of this report.

In such manner, it was determined that, as of December 31, 2010, the Company had net admitted assets of \$1,809,946,002 and liabilities, exclusive of capital and surplus, of \$566,769,994. Thus, there existed for the additional protection of the policyholders, the amount of \$1,243,176,008 in the form of statutory reserves and unassigned funds.

In addition to the undersigned, Michael A. Mayberry, FSA, MAAA of Lewis & Ellis, Inc., Actuaries and Consultants, Richardson, Texas, Joe Detrick, CPA, CISA, AES, CFE, IT Specialist, Jennan Enterprises, LLC, Jenny Jeffers, AES, CISA, IT Specialist, Jennan Enterprises, LLC, David R. White, CFE-EIC, Insurance Examiner, State of Tennessee, Sandy Banks, Insurance Examiner, State of Tennessee, Rebecca Walker, Insurance Examiner, State of Tennessee, and Gregory Bronson, CIE, MCM, ALMI, AIRC, State of Tennessee, participated in the work of this examination.

Respectfully submitted,



Brian H. Sewell, CFE
Examiner-in-Charge
State of Tennessee
Southeastern Zone, NAIC

AFFIDAVIT

The undersigned deposes and says that he has duly executed the attached examination report of BlueCross BlueShield of Tennessee, Inc. dated June 20, 2012, and made as of December 31, 2010, on behalf of the TDCI. Deponent further says he is familiar with such instrument and the contents thereof, and that the facts therein set forth are true to the best of his knowledge, information and belief.

Brian H. Sewell

Brian H. Sewell, CFE
Examiner-in Charge
State of Tennessee
Southeastern Zone, NAIC

Subscribed and sworn to before me this

20 day of June, 2012

Notary Tina Geisler

County Hamilton

State Tennessee

Commission Expires 2/3/2015



ORGANIZATIONAL CHART

